ORRICK

ORRICK, HERRINGTON & SUTCLIFFE LLP
666 FIFTH AVENUE
NEW YORK, NY 10103-0001
tel 212-506-5000
fax 212-506-5151
WWW.ORRICK.COM

April 10, 2009

VIA E-MAIL AND COURIER

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Legacy Loans Program – Request for Comment

Dear Mr. Feldman:

Orrick, Herrington & Sutcliffe LLP is an international law firm with offices in the United States, Europe, and Asia. Since the Legacy Loans Program was announced on March 23, 2009, we have had conversations about the Program with a number of our financial institution, investor, asset manager and other market participant clients. We appreciate the opportunity to respond to the FDIC's request for comment. The responses below are based on our client conversations as well as our own experience. Each question is reprinted below followed by a response.

1. **Asset Eligibility Requirements** Which asset categories should be eligible for sale through the LLP? Should the program initially focus only on legacy real estate assets or should any asset on bank balance sheets be eligible for sale? Are there specific portfolios where there would be more or less interest in selling through the LLP?

   The FDIC uses the term "Legacy Loans" in the release describing the program but the term "legacy" is not defined. Does the term refer to assets originated prior to a date to be specified, e.g. January 1, 2009, as is the case for commercial mortgage backed and residential mortgage backed securities according to the Legacy Securities PPIF Frequently Asked Questions release? Is this term intended to apply only to assets acquired by a bank from a company it has acquired or assets acquired by a bank from a third party, as opposed to assets originated by the bank? Must a bank own assets for a specified period of time before selling the assets to a PPIF?

   Based on the objectives expressed by Treasury and the FDIC, the assets to be sold should be those that are "clogging the system" and thereby precluding "greater lending and economic growth". These may be residential mortgages, commercial mortgages, commercial real estate loans (including mezzanine loans and junior and pari passu participation interests in commercial real estate loans, regardless of whether such loans are documented as a single note or multiple note structure), municipal securities, corporate loans, credit card receivables or other assets.

It is important that the FDIC be specific about the assets to be covered. It would also be preferable to give a bank that proposes to sell assets through this program the opportunity to sell any assets on its balance sheet after consultation with its primary regulator.

2. **Liquidity of Investors' Interests** Should the initial investors be permitted to pledge, sell or transfer their interests in the PPIF? If so, how should the FDIC ensure that subsequent investors meet the program's criteria for investors?

   Initial investors in the PPIF should be permitted to pledge, sell or transfer their interests in the PPIF, to the extent the pledgee, purchaser or transferee (as the case may be) would itself be an eligible investor in the PPIF. As the FDIC has not yet published program criteria for investors, it is not currently possible to describe how the FDIC will be able to ensure that any subsequent investor meets the criteria, but it is possible for the FDIC to implement program mechanics that will provide such assurance.

   It will be helpful for the program criteria for transferability to be consistent with established market standards (for example, it would be reasonable for the program criteria for a pool of apartment portfolio debt to be similar to the assumability standards for FNMA/FHLMC apartment debt).

   Subject to the need to satisfy all applicable securities law requirements, we expect that making the initial and subsequent investors' equity interests in a PPIF freely transferable will attract greater investor interest, enhance the value of such interests, and thereby assist in the government's goal of providing sellers with the best possible price for the assets sold to the PPIF.

   In any event, the criteria for eligible investors should be broad and inclusive. The objective of selling assets to private investors through the PPIF structure will be achieved most effectively by bringing to bear the financial resources of the widest possible group of investors.

3. **Equity Participation of Treasury** What is the appropriate percentage of government equity participation which will maximize returns for taxpayers while assuring integrity in the pricing by private investors? How would a higher investment percentage on the part of the government impact private investment in PPIFs? Should the amount of the government's investment depend on the type of portfolio?

If there are limits in the market to the amount of equity available to buy certain assets that may be auctioned, Treasury equity may be required in order to complete a transaction. On the other hand, if Treasury were to demand significant percentages of equity in a transaction in which there is ample market supply of capital, private investors may be disinclined to do the work required to make a bid if their opportunity to put money to work is limited.

Each auction should permit the bidders to require Treasury equity up to the 50% maximum level specified. If a cost is ascribed to this call on Treasury, smaller investors who need to call on the Treasury's capital to complete a transaction would be disadvantaged. Large investors would generally prefer to have a larger equity investment for themselves. The higher the percentage ownership by the Treasury, the greater the disincentive for private investors to invest significant amounts of time and money, especially with respect to the more troubled asset pools that require the most attention.

Please clarify whether Treasury will fund its equity investment upfront or over time. If Treasury commits to fund over time, Treasury should not be able to cease funding its equity commitment in its discretion (as suggested with respect to the Legacy Securities Program). Private investors who have committed capital will need to be able to rely on Treasury as an equity-funding partner if Treasury has committed funds to the PPIF.

4. **Disclosure of Investor Identity** Is there any reason that investors' identities should not be made publicly available?

Making investor identities publicly available, otherwise than by the investors themselves, may feed additional public and political backlash that could dissuade groups of investors from participating in the auctions. In addition, it is typical for passive/limited partner-type investors to remain anonymous. On the other hand, the FDIC traditionally announces the name of the winning bidder in its auctions and there is great value in the transparency of government processes. At a minimum, bidder identities should not be disclosed and lead investor identities should be disclosed, if at all, when a transaction is closed. The identity of the asset manager should be made publicly available.

In any event, it should be stressed that assurance by the government will be required that an investor's participation in this government program, and profiting from doing so, will not subject the investor to subsequent regulation, excessive taxation or other political backlash related to such participation.

5. **Broadening Participation** How can the FDIC best encourage a broad and diverse range of investment participation? How can the FDIC best structure the valuation and bidding process to motivate sellers to bring assets to the PPIF?

Investment Participation:

- The FDIC needs to create an auction process that attracts the widest possible base of potential investors (including foreign entities such as sovereign wealth funds). The objective is to move assets off of the books of the banks, at the highest possible price, and this objective can best be met by providing for the broadest possible group of permitted investors, subject to the satisfaction of applicable money laundering laws, applicable "know your customer" rules and similar requirements consistent with appropriate government oversight of the capital markets. Including certain foreign investors may also be important and helpful to the FDIC in meeting these goals. For example, it would be helpful if foreign banks could participate (with appropriate backing/support of foreign central banks) since, for example, substantial amounts of commercial mortgage legacy loans that will mature in the near term involve foreign bank participation in the credits.
- The rules regarding auction procedures must be clear and must be widely disseminated.
- Comprehensive information regarding the assets to be auctioned must be made available on a timely basis, giving potential investors sufficient time to consider and evaluate a bid.
- Bidders should have access to the FDIC's due diligence.
- Bidders should have access to the valuation performed by the FDIC's independent third party valuation consultant.
- Bidders should be permitted to conduct comprehensive due diligence and should be entitled to reimbursement for due diligence expenses (as is customary in private sector transactions, after an initial round of bidding). If the selling banks do not reimburse investors' due diligence expenses, investors are less likely to spend the time and money necessary to complete comprehensive due diligence. To the extent that the investors have uncertainty as to the asset quality or value as a result of limited due diligence, it will be reflected in a lower bid price.
- The inherent uncertainty of purchasing difficult assets even after due diligence will decrease investor interest unless investors have the right to put assets back to selling banks for breaches of representations and warranties. Accordingly, certain investors may demand comprehensive reps and warranties and related buy back provisions for breaches with respect to certain pools of assets, and other investors may trade off some or all of such protection in exchange for price concessions. Although the FDIC may prefer the simplicity of a standard set of reps and warranties with respect to each pool, bidders should be given the flexibility to provide non-conforming bids with specifications regarding reps and warranties and other terms.
- To promote uniformity and consistency of bids, the FDIC/Treasury should provide bidders with a transaction structure on which investors must bid. Bidders should also be able to propose non-confirming bids/alternative structures to the Treasury and the FDIC.

- o Bidders must be given some assurance that pools put out to bid will actually be sold through the disclosure of realistic reserve prices or otherwise.
- o The investors' interests should be transferable, as discussed in Question 2 above.
- o Treasury will need to disclose the terms of the warrants in the PPIF that it proposes to take.
- o Bidders must be given assurances by the government that their participation in this government program, and profiting from doing so, will not subject the bidder to subsequent regulation, excessive taxation or other political backlash related to such participation.
- o The FDIC has said that "passive investors" will not be subject to executive compensation restrictions. As indicated below, we expect that investors who purchase pools will want in most cases to take over servicing and to be responsible to manage the assets in the pool. Imposition of executive compensation restrictions on investors who take over asset management and/or servicing may substantially limit the number of investors willing to participate in the program.

Motivating Sellers:

- o Structure the auction as described above to get the best pricing from the market.
- o Permit bidders to offer upside sharing to the selling bank and permit banks to take back an upside share in the form of equity in the PPIF or otherwise. If treated as additional consideration, the reasonable value of the upside sharing participation will diminish the loss to be recognized.
- o Consider providing capital relief to banks that sell assets at a substantial loss through capital forbearance agreements, net worth certificates or other similar methods.
- o Permit sellers to determine whether to sell assets based on price, reps and warranties and all other terms. Note of course that the more certainty there is as to whether a bank that has put assets out to bid will actually sell the assets (publication of a reserve price, and of reps and warranties and other terms that the bank will agree to, etc.), the more likely that investor interest will develop.

6. **Auction Process** What type of auction process facilitates the broadest investor participation? Should we require investors to bid on the entire equity stake of a PPIF, or should we allow investors to bid on partial stakes in a PPIF? If the latter, would a Dutch auction process or some other structure provide the best mechanism for bridging the potential gap between what investors might bid and recoverable value? If multiple investors are allowed to bid through a Dutch auction, or similar process, how should asset management control be determined?

Giving investors the opportunity to bid on all or portions of pools of assets in the auction may facilitate broader investor participation. However, allowing bidders to bid on partial stakes in a PPIF can lead to great confusion. Investors should be required to bid individually for specific assets to go into their own PPIF or to bid with a prearranged group of other investors in a single bidding group. A Dutch auction for the PPIF interests should be avoided.

Structuring the auction as described in response to question 5 above will help to get the best pricing from the market.

While we refer to a number of possible alternatives throughout our response (e.g. allowing investors to bid based on tailored reps and warranties and other terms and conditions, etc.), it may be preferable for the FDIC to produce a comprehensive bid package for each auction while permitting non-conforming bids at the same time.

7. **Initial Auctions** What priorities (i.e., types of assets) should the FDIC consider in deciding which pools to set for the initial PPIF auctions?

Initial PPIF auctions should be structured to create a foundation for the program by including relatively easy to understand assets (e.g. performing residential mortgages) from a highly regarded seller that will attract a large number of investors. However, it will also be important to commence auctions for the types of assets.that are subject to the most immediate re-financing needs (such as municipal debt securities and commercial real estate loans) as soon as possible.

8. **Asset Pools** What are the optimal size and characteristics of a pool for a PPIF?

Size should be large enough to make it worth the effort but should not be so large as to shut out smaller investors. In general, large investors will prefer larger pools. Pool size will also vary with the type and quality of the assets being sold.

Asset pools should be homogeneous as to asset type, e.g., construction loans should not be combined with residential mortgages and non-performing loans should not be combined with performing loans.

9. **PPIF Debt Financing** What parameters of the note and its rate structure would be essential for a potential private capital investor to know at the time of the equity auction to provide equity?

It is important for investors to know all material terms of the debt financing before they submit bids, including:

- o Multiple of leverage
- o Term
- o Interest rate
- o Principal repayment terms; investors are likely to prefer that the PPIF maintain its leverage for the term of the debt and, therefore, that the debt be payable only at maturity (subject possibly to call features that permit the PPIF to reduce the debt if asset cash flows permit).
- o Covenants
- o FDIC guarantee fee
- o Security
- o FDIC approval rights regarding loan extensions/restructuring of loan assets in pool
- o Circumstances in which release/substitution of collateral is permitted

10. **Debt as Consideration for Assets** Would it be preferable for the selling bank to take a note from the PPIF in exchange for the pool of loans and other assets that it sells? Alternatively, what would be the advantages and disadvantages of structuring the program so that the PPIF issues debt publicly in order to pay cash to the selling bank? Would a public issuance of debt by the PPIF limit its flexibility compared to the issuance of a note to a selling bank?

We expect that selling banks will prefer to take cash from the PPIF rather than a note. While a note may nominally be of equivalent value, the lack of liquidity for the note could in fact impair its value to the holder.

On the other hand, we expect that investors will prefer that the selling bank take a note in lieu of cash of equivalent value.

In any event, it would be helpful for the FDIC to confirm that any such FDIC-guaranteed note will be risk-weighted at zero percent.

The FDIC will have to weigh in each case the needs of the selling bank for liquidity and the impact on price if the PPIF is required to pay cash for the assets sold to the fund and to issue debt in the market to fund the asset purchase.

A public offering of notes would require SEC registration and costs and would be subject to the risks of the public markets, even for FDIC guaranteed debt, unless the FDIC were to obtain a No-Action Letter from the SEC comparable to the one obtained for the Temporary Liquidity Guarantee Program.

If private investors acquire the FDIC guaranteed note, consideration should be given to expansion of TALF to provide New York Fed funding backed by the notes.

11. **FDIC Guarantee Fee** In return for its guarantee of the debt of the PPIF, the FDIC will be paid an annual fee based on the amount of debt outstanding. Should the guarantee fee be adjusted based on the risk characteristics of the underlying pool or other criteria?

    Some investors have expressed the view that the fee should be based solely on pool size.

    Does the FDIC want to address program amount allocation or risk with its fee? If the latter, the guarantee fee should be based on the risk characteristics of the underlying pool. The independent valuation conducted for the FDIC would provide guidance in this regard. If the greater objective of the FDIC is to facilitate the ability of the banks to move risk off of their balance sheets, a significant guarantee fee will increase the cost of doing so. Whatever approaches the FDIC selects for determining its fee, investors will factor the fee into their bid prices.

12. **Return on Treasury's Investment** Should the program include provisions under which the government would increase its participation in any investment returns that exceed a specified trigger level? If so, what would be the appropriate level and how should that participation be structured?

    The program should be structured in every way possible to encourage widespread and robust investor participation while balancing the desire of the government to retain upside for taxpayers. Treasury should also balance its desire to retain upside for taxpayers generally with incentives to get banks to sell, including possible retention by selling banks of some upside participation.

    Treasury will benefit from greater than expected returns in its capacity as an equity holder in the PPIF as well as, possibly, through its warrants. Investors will also, of course, benefit in their capacity as equity holders. Investors may determine to allocate a portion of such upside, which would otherwise inure to the benefit of Treasury and the investors, to the servicer and asset manger for the PPIF.

13. **Multiple Seller Pools** Should the program permit multiple selling banks to pool assets for sale? If so, what constraints should be applied to such pooling arrangements? How can the PPIF structure equitably accommodate participation by smaller institutions? Under what process would proceeds be allocated to selling banks if they pool assets?

While multiple seller pools may be useful in order to get the size required to benefit from economies of scale for transaction expenses, multiple seller pools also involve the difficulties suggested in the question.

A multiple seller pool approach could work if each of the selling banks agrees to the values that the FDIC's third party valuation consultant ascribes to each of the pools in the transaction and also agree that its share of the proceeds of sale to the PPIF will be determined on a pro rata basis based on those valuations. Obtaining such agreement from the selling banks would be no small task.

A multiple seller pool approach could also work if bidders are asked to value each pool in the transaction independent of the others. Proceeds would be remitted to each of the selling banks based on the value ascribed to the pool by the winning bidder. If a minimum price is specified but not achieved for a particular seller's pool, it will raise the issue whether bidders would have the right to withdraw bids for other seller pools included in the multiple seller pool transaction.

If multiple seller pools are not permitted, smaller banks may not have the opportunity to participate in the program as the dollar amount of loans they could offer individually may be insufficient to attract investor interest.

14. **Possible Conflicts** What are the potential conflicts which could arise among LLP participants? What structural arrangements and safeguards should the FDIC put into place to address or mitigate those concerns?

LLP participants will be the private investor, Treasury, the FDIC, the asset manager, the servicer and, if any upside is retained, the selling bank. The private investor should choose the servicer and the asset manager.

Interests of the private investor and Treasury, as owners of the equity, will differ to the extent that Treasury will have political as well as economic objectives may also be impacted by virtue of Treasury's interest in warrants of the PPIF.

The FDIC's guarantee of PPIF debt will, presumably, be called upon only after recourse to the assets of the PPIF pledged to secure the debt. Accordingly, the FDIC will have an interest in the PPIF that is senior to the interest of the equity investors.

Any interest of the selling bank will be defined by the terms of any upside sharing agreement.

There could be conflicts over sales or restructuring of loans, funding of additional capital, distribution of sale, repayment or refinancing proceeds, exercise of lender remedies, resolution of disputes with borrowers, tenants and other third parties and valuation and disposition of and seller financing for REO collateral. What if a party fails to fund a future capital call? Varied interests between senior security holders, junior participants and special servicers that arose in connection with changes to REMIC Rules regarding loan extensions and REO financing are illustrations of certain such conflicts.

All of these conflict issues and more need to be negotiated between and among program participants based on the interests of the parties in particular transactions.

15. **Asset Management** What should the relative role of the government and private sector be in the selection and oversight of asset managers? How can the FDIC most effectively oversee asset management to protect the government's investment, while providing flexibility for working assets in a way which promotes profitability for both public and private investors?

Investors will want to control asset management and servicing. In the case of non-performing residential mortgages as well as in the case of commercial real estate loans, particularly if they are non-performing, it is especially important to transfer the servicing with the asset.

The FDIC can most effectively provide any required oversight by proposing a clear set of rules or criteria, soliciting comments on the proposal and then setting forth the terms agreeable to the FDIC under which asset managers and servicers will be required to operate in the LLP, all subject to specified oversight by the FDIC. The tighter the rules and the more stringent the oversight, the less attractive the program may be to investors. Finally, it is important for a realistic, market-based asset management fee to be established.

16. **Valuation of Servicing** How should on-going servicing requirements of underlying assets be sold to a PPIF and paid for? Should value be separately attributed to control of the servicing rights?

Investors should be given the option to combine their bid for assets with their bid for servicing. In most cases, investors will prefer to control the servicing for the assets in which they are investing and will not want the servicing to be sold separately. It would be preferable for all assets to be sold on a servicing-released basis.

17. **Independent Asset Valuation** Should data used by the independent valuation consultant, as well as results of such consultant's analysis, be made available to potential bidders? Should it be made available to potential sellers prior to their decision to submit assets to bid?

ORRICK

Such data and results should be made available to potential sellers prior to their decision to submit assets to bid in order to assist in their decision-making process, as well as to avoid second-guessing and criticism of the process after a transaction is completed. Such data and results should also be made available to potential bidders.

Although bidders are likely to want to conduct their own independent due diligence in any event, making such information available to bidders on a timely basis, with enough time to evaluate such information prior to a bid, could reduce uncertainty with regard to the characteristics and performance of the assets and thereby facilitate and improve the bid process. Uncertainty could also be reduced if bidders knew there was a minimum price that selling banks had agreed to accept.

* * * * * * *

Thank you for the opportunity to comment on the Legacy Loans Program. If you have any question or would like to discuss any of the foregoing, please do not hesitate to contact any of the undersigned.

Very truly yours,

Howard S. Altarescu
(212) 506-5315; haltarescu@orrick.com

David S. Katz
(202) 339-8497; dkatz@orrick.com

James J. Croke
(212) 506-5085; jcroke@orrick.com